Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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| In the Matter of | ) | |
| | ) | |
| Federal-State Joint Conference | ) | WC Docket No. 02-269 |
| On Accounting Issues | ) | |

REPLY COMMENTS OF QWEST CORPORATION

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Qwest Corporation ("Qwest") hereby submits its reply comments in the above-captioned proceeding.

## I. INTRODUCTION AND SUMMARY

In this docket the Federal Communications Commission ("FCC" or "Commission"), through the Joint Conference, seeks input on how its regulatory accounting and reporting rules should be reconfigured in order to comply with the directive of Section 11(b) of the 1996 Telecommunications Act that all regulations that are not "necessary in the public interest" be repealed or modified. The touchstone of this analysis coincides with the essential market-opening and deregulatory impetus of the 1996 Act: whether the regulation in question is no longer necessary "as a result of meaningful economic competition. . ." In these reply comments, Qwest Corporation ("Qwest") submits that the FCC should seek to reduce special regulatory accounting and reporting rules to a bare minimum. To a very large extent existing regulatory accounting and reporting rules are anachronistic, no longer suited to the vital task of evaluating meaningful competition in the marketplace, and unnecessarily duplicative of accounting and reporting requirements that exist independent of the FCC -- primarily Generally Accepted Accounting Practices ("GAAP") accounting and the reporting requirements of the Securities and Exchange Commission ("SEC").

The key to a proper analysis of the "necessary" requirement of Section 11 of the 1996 Act is whether a particular regulatory accounting rule or reporting requirement addresses a demonstrable regulatory need in a rational and minimalist fashion. This requires a two-part analysis. First, is the information that the accounting or reporting requirement seeks itself directly relevant to a legitimate regulatory need of the FCC? Information that is simply useful to the FCC does not meet this requirement. In this regard, special accounting or reporting rules applicable only to a limited segment of the industry (*e.g.*, ARMIS Reporting) generally do not meet this test because such information cannot provide a valid basis for evaluating the extent of meaningful competition. Second, is the information reasonably available from other sources? GAAP accounting principles provide a sound and universal basis for uniform accounting among all industry participants (not just those currently subject to regulatory accounting rules), and SEC reporting requirements provide a foundation upon which universally-available information can be reviewed and refined. Should the FCC need information that is not provided through these vehicles (in addition to the FCC reporting requirements in other areas, such as universal service), the FCC must start with these other vehicles and build additions only where necessary. The FCC may not retain accounting and reporting rules that simply duplicate what is otherwise available through other sources.

Finally, in examining accounting and reporting rules, it is imperative that the FCC keep in mind that the purpose of such rules must focus on the evaluation of the development of competition in the telecommunications marketplace. As competition continues to develop, such competitive determinations will ultimately be the primary focus of all FCC regulation of carriers and other market participants. If the FCC's accounting and reporting rules apply to only a limited segment of the telecommunications industry, those rules will be useless in carrying out the pro-competitive regulatory task to which they must be directed. Accordingly, the FCC should seriously examine all accounting and reporting rules that apply only to incumbent local exchange carriers ("ILEC"). Such rules do not pass the "necessary" test because they are not useful in fulfilling the task that is used to justify their existence.

## II. USE OF THE TERM "NECESSARY" IN SECTION 11(b) PRECLUDES CONTINUATION OF REGULATIONS THAT DO NOT SERVE A DEMONSTRABLE AND IMPORTANT REGULATORY PURPOSE.

The proper meaning of the term "necessary" in Section 11(b) of the Act[1] continues to cause controversy, because the Commission is constrained by the Act to eliminate or modify all rules that are not "necessary in the public interest." A number of commentors contend that "necessary" in this section of the Act should be interpreted as akin to "useful,"[2] rather than accepting the customary meaning of the word.[3] This issue has been raised as an open one by members of this Commission in other contexts.[4] For example, the February 5, 2003 edition of Communications Daily reported the following speech by Commissioner Kevin Martin:

> Martin said he was concerned by failure to discuss legal standard of Sec. 11 under which FCC must determine in biennial reviews whether regulation no longer was 'necessary in the public interest' as a result of meaningful competition between providers. [The] meaning of 'necessary' has surfaced in biennial review obligations, forbearance petitions and unbundling obligations, in which FCC must

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[1] 47 U.S.C. § 161(b).

[2] *See, e.g.*, AT&T Corp. ("AT&T") at 5, "Recent proceedings illustrate the usefulness of the existing regulatory accounts for protecting competition."; Florida Public Service Commission ("FPSC") at 3, "Additional benefits obtained from the accounts under consideration could result from their usefulness to states in setting policy direction."

[3] *See* Verizon at 5 "The common or ordinary definition of 'necessary' is 'absolutely required,' 'indispensable,' or 'essential.' *Merriam Webster's Collegiate Dictionary*, 774 (10th ed. 2001)."

[4] *See also* Consolidated Separate Statement of Commissioner Kevin J. Martin, Approving in Part and Concurring in Part, *In the Matter of Year 2000 Biennial Regulatory Review -- Amendment of Part 22 of the Commission's Rules to Modify or Eliminate Outdated Rules Affecting the Cellular Radiotelephone Service and other Commercial Mobile Radio Services*, *Report and Order*, 17 FCC Rcd. 18401, 18466 (2002) ("I believe the term 'necessary' should be read in accordance with its plain meaning, to mean something closer to 'essential.'").

> unbundle what no longer is necessary, Martin said. 'There has become an increasing emphasis on our implementation of that and what that word means,' he said. 'I think it could have a significant impact on the way that we are addressing some of our regulations.' He cited example of wireless local number portability requirements, in which wireless industry sought FCC forbearance last year. Question was what was standard for what 'necessary' meant. 'Does it mean something is truly essential or does it mean something is just useful or helpful,' he asked. 'The distinction between those 2 meanings could have an important significance. If we're supposed to get rid of rules that are no longer necessary but necessary just means useful or helpful, I think the Commission has a lot more latitude. On the other hand, if it means we can only keep things that are essential in light of the competition that is there, that is a more significant burden that the Commissions must face.'[5]

Commissioner Martin has it exactly right -- how the term "necessary" is interpreted in the future will impact all aspects of telecommunications regulation and the telecommunications market. However, the FCC is not free to define "necessary" in any manner it sees fit. The term carries a mandate that goes far beyond such general terms as "useful." Those commentors who seek to define "necessary" as "useful" would fracture both the English language and the meaning of the statute. The class of regulations that are "necessary in the public interest" is limited to those regulations that address a demonstrable regulatory need in a rational and minimalist fashion.

The statutory requirement that a particular rule be "necessary" appears elsewhere in the 1996 Act. The FCC must find that a proprietary network element is "necessary" before requiring that it be unbundled as a network element,[6] and that collocation is "necessary for interconnection or access to unbundled elements" as a prerequisite to ordering physical collocation.[7] While courts have agreed that the term is ambiguous for purposes of statutory interpretation, they have

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[5] *See* "Lines Continue to be Drawn Over Pending Triennial Review Order," Communications Daily, dated Feb. 5, 2003.

[6] 47 U.S.C. § 251(d)(2)(A).

[7] 47 U.S.C. § 251(c)(6).

rejected efforts to permit definition of the term as connoting nothing stronger than "useful."[8] In arriving at a regulatory interpretation of the word "necessary," it is imperative that the Commission use its reasoned judgment to develop a meaning that is consistent with Congressional intent.[9] Congressional intent requires that "necessary" be read as a powerful deregulatory mandate wherever competitive market forces so dictate.

The Commission cannot simply apply a "used" or "useful" criterion to justify the continuation of an existing accounting regulation under the "necessary" requirement of Section 11(b). Courts have twice rejected such an interpretation of the same word in other sections of the Act,[10] and there is no reason to conclude that adoption of such a criterion would fare any better on judicial review.[11] While courts prior to passage of the 1996 Act have been more lenient in allowing the Commission discretion to define the term "necessary in the public interest" broadly,[12] it would be imprudent at best for the FCC to take action under the new Act that could be read as flying in the face of at least two clear judicial directives. The standard precept of statutory interpretation that holds that Congress is assumed to attach the same meaning to the

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[8] *See GTE Service Corporation v. FCC*, 205 F.3d 416, 421 (D.C. Cir. 2000).

[9] *See*, *e.g.*, *WorldCom, Inc. v. FCC*, 288 F.3d 429, 432 (D.C. Cir. 2002), *mot. granted, request granted, reh'g en banc denied* (D.C. Cir. Sept. 24, 2002 and Sept. 25, 2002), *petition for cert.* filed (Dec. 23, 2002); *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 3 (D.C. Cir. 2000).

[10] The FCC *Orders* at issue in the court cases (*see* n.8, *supra* and n.11, *infra*) are *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, *First Report and Order and Further Notice of Proposed Rulemaking*, 14 FCC Rcd. 4761, 4776-77 ¶¶ 28-29 (1999); *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order*, 11 FCC Rcd. 15499, 15794 ¶ 579 (1996) ("*Local Competition Order*"); *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, *Fourth Report and Order*, 16 FCC Rcd. 15435, 15445-49 ¶¶ 18-26 (2001).

[11] *See AT&T Corp v. Iowa Utilities Board*, 525 U.S. 366, 388 (1999); *GTE Service Corporation*, 205 F.3d at 422-24; *Verizon Telephone Companies v. FCC*, 292 F.3d 903, 905 (D.C. Cir. 2002).

[12] *See Fox Television Stations, Inc. v. FCC*, 293 F.3d 537, 538-39 (D.C. Cir. 2002).

same word throughout a statute applies here.[13] Congress did not adopt the word "necessary" in Section 11(b) of the Act as a means of granting the Commission authority to retain all existing regulations simply on the basis that they are "useful." Otherwise Section 11(b) of the Act would have no meaning at all.

One of the key purposes of the 1996 Act was to bring about as much deregulation in the telecommunications sector as was feasible based on the extent of competition -- an evaluation that the FCC is required to undertake every two years in order that the actual state of competition can be examined on a current basis.[14] In this context, Congress' clear purpose in passing the 1996 Act was to bring about deregulation of telecommunications and cable services and to create a regulatory landscape in which only those regulations that actually furthered the FCC's ability to regulate in the public interest were retained. The touchstone of this requirement was the advent of "meaningful competition " in the marketplace.[15] Congress' direction to the FCC for this limited class of regulations was the term "necessary" in Section 11(b) of the Act.

The term "necessary" accordingly connotes Congressional intent that the FCC will eliminate all regulations, including accounting and reporting rules, that are not demonstrably a vital part of the structure that permits the Commission to carry out its statutory duties in a reasonable and efficient manner. "Necessary" in the context of the Act implies that the Commission will not presume that any regulation should be retained simply on the basis that it is

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[13] *See* Karl N. Llewellyn, Remarks on the Theory of Appellate Decision and Rules or Canons about How Statutes are to be Construed, reprinted in 2A, Norman J. Singer, Statutes and Statutory Construction 539, 544 (5th Ed. 1992).

[14] 47 U.S.C. § 161(a).

[15] The use of the phrase "meaningful competition" in Section 11(b) coincides with Qwest's main point on this issue. The FCC's accounting and reporting rules should primarily target the extent, scope and impact of "meaningful competition." It is for this reason, as noted below, that accounting and reporting rules that do not apply to the entire industry have little hope of passing the "necessary" test of Section 11(b).

already on the books. If a particular accounting or reporting rule cannot pass this test, it must be eliminated.

In Qwest's February 13, 2001 comments in Phase 3 of the FCC's comprehensive review of accounting and reporting requirements under Section 11 of the 1996 Act, Qwest set forth a straightforward formula pursuant to which a proper "necessary" analysis could be undertaken in the area of accounting and reporting rules.[16] This approach would use two steps. In the first step, the FCC would assess the relevance of the information to its regulatory goals. In the second step, the Commission would analyze alternative (and less burdensome) means of obtaining that information, retaining the rule only if more efficient and less burdensome alternatives were not available. Qwest's proposition, updated to recognize the increasing importance of directing the FCC's regulatory efforts towards competition in the telecommunications marketplace, can be summarized as follows:

*Step 1 -- Relevance*

- Is the information part of an industry-wide evaluation of competition and competitive market forces in the telecommunications industry?[17]
- Is the information required to regulate ILECs in a price cap/CALLS environment?
- Is the information required to discharge the FCC's obligation to ensure adequate Universal Service Fund support?
- Is the information required to protect consumers from cross-subsidies?[18]

[16] Comments of Qwest Corporation, CC Docket No. 00-199, filed Feb. 13, 2001 at 5-7.

[17] This information will be the most critical part of the FCC's information efforts.

[18] As is noted below, Qwest is of the opinion that special regulatory accounting rules are not necessary for the detection and prevention of cross-subsidization. Nevertheless, especially given the statutory prohibition against cross-subsidization, 47 U.S.C. § 254(k), Qwest agrees that it is reasonable and valid for the FCC to assess whether a particular accounting rule protects consumers from cross-subsidization.

To the extent that information is relevant, there should be a presumption in favor of collection from all industry participants. Otherwise the Commission cannot fulfill its obligation under Section 11 to determine whether the information is necessary for regulation "as a result of meaningful economic competition between providers." Without information for all providers, the Commission cannot possibly make the reasoned decisions required by the Act.

*Step 2 -- Alternate availability*

If the answer to any one of the first set of questions is in the affirmative, the FCC then must ask and answer the following questions:

- Is the information or a reasonable proxy already being reported to or compiled at the direction of another federal agency or reliable source?
- If the information is needed and a reasonable proxy is not available from other sources, is the information required to be formatted/compiled/reported on a regular basis or is it sufficient to put ILECs on notice that they must be prepared to provide the data on request?
- If the information is required at regular intervals or upon request, what is the minimal level of detail (*i.e.*, the highest level of aggregation) required for the FCC to perform its duties?
- What alternative sources of information can be used that are less burdensome on carriers subject to the rules?
- How can the information request be structured in order that it can be collected in the least intrusive manner from the entire industry?

The result of applying such a two-part test to existing accounting and reporting regulations would be the development of a minimal set of accounting and reporting requirements that would satisfy Section 11: the FCC would obtain the information it needed to regulate in the public interest; and the accounting and reporting rules would be no more intrusive than is "necessary" to accomplish this purpose.

## III. COMMENTORS SUPPORTING THE CONTINUATION OF UNIQUE REGULATORY ACCOUNTING RULES FAIL TO ESTABLISH WHY OTHER EXTANT ACCOUNTING RULES APPLICABLE TO A LARGER INDUSTRY SEGMENT DO NOT PROVIDE REASONABLE AND ACCURATE INFORMATION IN TODAY'S MARKET.

To a large extent, commentors supporting retention or expansion of the existing regulatory accounting rules focus almost entirely on the assertion that the information in regulatory accounts is information that the FCC needs, and that therefore the rules should be retained.[19] A proper analytical structure permits the FCC to simply dismiss these types of comments because they bypass the critical statutory question: is the accounting rule in question, in the context of the overall industry and market environment, really "necessary" to enable the FCC to regulate in the public interest? In the context of the two-part test set forth above, such commentors, by contenting themselves with analysis that focuses on the first question (is the information "necessary" to regulation in the public interest), never really come to grips with the question of whether the rule itself is necessary. While in many instances these commentors have failed to even address question 1 in an adequate manner, by failing to focus on whether an accounting requirement is necessary, regardless of the status of the information, these

[19] AT&T at 6, "Even aside from protecting consumers and competition from the exercise of market power, the Commission's regulatory accounts serve other important functions" (*i.e.,* universal service program, ensures that ILECs are charging "just and reasonable" rates for interstate services, and implementation of the price cap mechanism).; FPSC at 3, "These additions appear to be appropriate and necessary to enable the FCC to maintain an up-to-date accounting system. These accounts should enable the FCC and states to continue to understand the nature of the ILECs' investment and ensure that prices are reflective of their actual costs." National Association of State Utility Consumer Advocates ("NASUCA") at 4-5, "As is recognized by the Joint Conference, state and federal telecommunications policy makers use regulatory accounting data and related information for many purposes, including to determine interstate and intrastate rates, such as access charges, unbundled network element ("UNE") charges and end-user rates; to evaluate jurisdictional separations; and to calculate universal service support."; North Carolina Utilities Commission -- Public Staff ("North Carolina") at 3, "The FCC, as the only regulatory body possessing jurisdiction over all the major ILECs, is uniquely positioned to prescribe national uniform accounting rules that permit all regulators, including the FCC, to adequately perform their oversight responsibilities."

commentors have essentially trivialized their participation in this docket. A special regulatory accounting rule cannot be justified under the "necessary" test simply because the information is "necessary" to the FCC. If the information is readily available to the FCC through other means (in the case of accounting rules, GAAP accounting and SEC for the most part), there is no basis on which the rule can be retained notwithstanding the fact that the information is necessary. Failure to analyze, for example, how SEC reports can meet the FCC's information needs (or supplemented where the FCC's needs diverge from the SEC reports) would leave the FCC out of compliance with the "necessary" test. Stated simply, if information is necessary to the FCC but otherwise available without a unique regulatory accounting rule, the rule itself does not meet the "necessary" test.

### A. Unique Regulatory Accounting Rules Cannot Be Justified Based On Concerns About Unlawful Cross-Subsidization Because Cross-Subsidization Is A Legitimate Concern Only When A Carrier's Rates Are Rate-Base Regulated.

A number of commentors claim that unique regulatory accounting rules are necessary to protect the public against "cross-subsidization" by ILECs.[20] This argument demonstrates with clarity the danger of failing to match the accounting rules in question with current market reality. The FCC's current accounting rules were developed in a market and regulatory environment that was completely different from today's environment. Specifically, when the current accounting rules were adopted, ILECs were universally regulated based on "rate-of-return" regulation for all of their important interstate services. At the interstate level, rate-of-return regulation is applicable today to only a small number of smaller ILECs and a very limited number of larger

[20] AT&T at 3, 5 and 11; NASUCA at 10, 12; Public Service Commission of Wisconsin ("Wisconsin") at 10.

ILEC services. State use of rate-of-return regulation is likewise rapidly disappearing.[21] The cross-subsidization concerns that supported adoption of the existing accounting rules simply do not exist in a price cap or deregulated environment.

Cross-subsidization is a variation of predatory pricing, and one that is, as an economic matter, limited to rate-of-return regulated monopolists. Predatory pricing involves a competitor deliberately pricing competitive services below cost in order to drive competitors out of the market. Cross-subsidization occurs when a rate-base regulated monopolist uses the costs of the competitive services to increase its regulated rates. In the absence of this unique situation involving a rate-of-return regulated monopolist, cross-subsidization cannot occur. Otherwise, the monopolist tempted to "cross-subsidize" could increase its profits more if it simply increased its monopoly prices without any price reduction in the competitive field.

Predatory pricing itself is generally viewed as economically-irrational behavior that rarely occurs in real life.[22] Such behavior is rational only in those rare instances where there is a very realistic possibility that the competition destroyed by the monopolist would disappear and not return once a monopoly had been established and monopoly rents were being charged (in an effort to recoup the losses caused by the predatory pricing). In a normal economic situation, there is no reason to assume that a monopolist would engage in predation because such activity would reduce its profits. This is true even if the potential predator had market power in another market and could charge supra-competitive prices in that market to cover the losses caused by its

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[21] In 1985, ILECs were regulated based on rate-of-return in all fifty states. Currently only eight states still use rate-of-return regulation to control ILEC prices. *See* The Impact of State Incentive Regulation on the U.S. Telecommunications Industry, by Chunrong Ai and David E. M. Sappington, Department of Economics, University of Florida, Gainesville, FL.

[22] *See Matsushita Electric Industrial Co., Ltd., et al. v. Zenith Radio Corp., et al.*, 475 U.S. 574, 596 (1986).

predatory pricing. It still would make no economic sense to undertake such behavior unless competition would be permanently destroyed.

There is one exception to this precept -- one that holds in the case of a regulated monopolist whose services are rate-of-return regulated. In that case the monopolist can, through cost shifting, inflate its rate base or regulated expenses in order to earn more from its monopoly services than regulators would otherwise allow, permitting the "predation" in the competitive marketplace to be cost free.[23] In other words, in a rate base/rate-of-return situation, a monopolist can actually increase its profits through cross-subsidization, and the predatory activity is no longer economically irrational. For this reason the FCC and state regulators, during the time when competition was first emerging and rate base regulated carriers (generally ILECs) were first beginning to offer competitive non-carrier services, spent a great deal of regulatory time and energy devising accounting rules to prevent cross-subsidization.[24] But otherwise, predatory pricing and cross-subsidization are not economically rational actions and generally do not present significant threats to competition.[25]

In applying this precept to the ability and incentives of ILECs to unlawfully cross-subsidize below-cost competitive services through excessive profits earned from services subject to less competition, the danger has been almost entirely eliminated now that rate-of-return regulation has been eliminated. If a monopolist gains nothing by shifting costs to its monopoly

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[23] Judge Posner set out this distinction in *Olympia Equipment Leasing Company v. Western Union Telegraph Company*, 797 F.2d 370, 374 (7th Cir. 1986).

[24] *In the Matter of Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, *Report and Order*, 2 FCC Rcd. 1298 (1987), *on recon.,* 2 FCC Rcd. 6283 (1987), *on further recon.*, 3 FCC Rcd. 6701 (1988), *aff'd sub nom. Southwestern Bell Corp.,* 896 F.2d 1378 (D.C. Cir. 1990).

[25] *Matsushita Electric*, 475 U.S. at 589.

services because its regulated rates are not based on a rate base or a rate-of-return, there is no incentive to cross-subsidize.

The Commission has long recognized that elimination of the dangers of cross-subsidization was one of the major benefits of price cap regulation. The premise was stated concisely in the *Report and Order and Second Further Notice of Proposed Rulemaking* in the initial price cap docket:

> The attractiveness of incentive regulation lies in its ability to replicate more accurately than rate of return the dynamic, consumer-oriented process that characterizes a competitive market. In general, such regulation operates by placing limits on the rates carriers may charge for services. In the face of such constraints, a carrier's primary means of increasing earnings are to enhance its efficiency and innovate in the provision of service. Because cost padding and cross-subsidization do not justify higher prices under this system -- but instead lower profits -- the incentives to engage in such activity are limited.[26]

The FCC reiterated this analysis five years later when reviewing the initial price cap rules:[27]

> [C]onsumers are protected from cross-subsidization by the grouping of similar services in price cap baskets, which prevents a carrier from raising rates in one basket and lowering them in another to the detriment of customers taking service in the first basket.

In examining price cap regulation for video dialtone in the same docket, the FCC reached the same conclusion:[28]

> Under price cap regulation, a carrier's ability and incentive to shift costs from one service to another is restricted by the grouping of services into baskets, each subject to its own price cap. Whenever a set of rates is subject to a price cap, carriers have no incentive to shift costs into the basket because the cap does not move in response to endogenous cost changes.

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[26] *In the Matter of Policy and Rules Concerning Rates for Dominant* Carriers, *Report and Order and Second Further Notice of Proposed Rulemaking*, 4 FCC Rcd. 2873, 2893 ¶ 36 (1989). *See also id.* at 2922 ¶ 101.

[27] *In the Matter of Price Cap Performance Review for Local Exchange Carriers*, 9 FCC Rcd. 1687, 1688 ¶ 12 (1994).

[28] *In the Matter of Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation*, 10 FCC Rcd. 3141, 3142 ¶ 1, n.2 (1995).

The FCC's analysis was clearly correct. Under price cap regulation -- by far the main method of currently regulating the price of ILEC services -- cross-subsidization concerns are dramatically reduced, if not eliminated altogether.[29]

In this context, accounting and reporting rules designed to protect against cross-subsidization by rate-of-return regulated carriers are inappropriate, or at least presumptively so. Not only is there a dramatically reduced risk that cross-subsidization will occur at all, but there is no real evidence that other accounting mechanisms (particularly GAAP accounting) will not be sufficient to permit the FCC to detect cross-subsidization if it does occur. Special regulatory accounting rules directed at detecting cross-subsidization should be eliminated in their entirely.

### B. The Need For Uniformity Of Accounting Practices By Carriers Does Not Justify Imposition Of Unique Regulatory Accounting Rules. GAAP Accounting Principles Already Ensure Uniformity Of Accounting Practices On An Industry-Wide Basis.

The failure of commentors properly to evaluate existing accounting rules under the "necessary" test is especially apparent in the case of their argument that existing rules should be retained because of the need for uniformity in carrier accounting practices.[30] The need for uniformity in accounting practices among carriers is self-evident and already extant -- uniform accounting practices are a cornerstone of a functioning competitive marketplace, and this need

[29] The likelihood of cross-subsidization is further lessened in those areas and for those services for which ILECs have what is known as "Phase 1" or "Phase 2" pricing flexibility. 47 C.F.R. § 69.710, *et seq*. In order to obtain pricing flexibility relief, ILECs must demonstrate that competitors have made irreversible, sunk investments in the facilities needed to provide the services at issue. The existence of sunk investment further reduces the likelihood of eliminating competition through cross-subsidization because the sunk investment can be reused by a successor-competitor with its cost of service being reduced because the sunk investment will be generally sold at avoidable cost under those circumstances. This concept has been referred to generally by the FCC in the past. *See*, *e.g.*, *In the Matter of Competition in the Interstate Interexchange Marketplace, Notice of Proposed Rulemaking*, 5 FCC Rcd. 2627, 2634 ¶ 57 (1990).

for uniformity applies well beyond the universe of carriers regulated by the FCC. But the fact that uniform accounting practices are necessary to effective regulation says nothing about whether the *FCC's* regulatory accounting rules should be retained. Indeed, because these rules apply only to a limited segment of the telecommunications industry, the principle of uniformity is not really served by the FCC's accounting rules. Moreover, uniformity of accounting practices and principles is already assured by the existence of GAAP and SEC reporting requirements.

AT&T, for example, finds legal support in the premise in 47 U.S.C. § 220(a)(2) that the FCC "shall, by rule, prescribe a uniform system of accounts for use by telephone companies." But AT&T then insists that the need for uniformity in accounting practices by carriers somehow eliminates the requirement that the FCC examine whether special regulatory rules are necessary to meet this requirement. No one doubts that carriers should maintain books of account based on uniform principles. The question is whether *additional* regulatory accounting rules are necessary to meet this need. Qwest submits that, in practically all instances, compliance with GAAP will meet the need for uniform accounting practices among telephone companies required in the Act as well as the FCC's needs. A mere need for uniformity in accounting practices by itself proves nothing in determining whether carriers should be required to maintain a separate set of accounting records solely for purposes of regulation.

AT&T's position on uniformity of accounting practices points to another anomaly in AT&T's argument. AT&T agrees that a primary purpose for FCC rules regarding accounting and reporting by carriers is to measure and evaluate competition.[31] This is in complete accord

[30] AT&T at 8; FPSC at 3-4; North Carolina at 3; Wisconsin at 17.

[31] AT&T goes so far as to call regulatory accounting a "cornerstone" of ensuring the development of competitive telecommunications markets. AT&T at 4-6.

with Qwest's position.[32] But the uniformity that AT&T demands does not apply to AT&T's books or accounting or to those of any other interexchange carriers ("IXC"), competitive local exchange carriers ("CLEC"), commercial mobile radio service ("CMRS") providers or other participants in the telecommunications market.[33] The regulated accounts that AT&T supports are to be maintained only by ILECs (primarily Regional Bell Operating Companies ("RBOC")). Thus, the accounting rules that AT&T propounds are incapable of performing the function that AT&T argues is one of the chief reasons for their existence. These accounting records cannot be used to perform meaningful competitive analyses because they are not maintained by a large segment of the telecommunications industry. The ILEC data cannot be compared to the equivalent data of any other carrier because the other carriers are not required to keep their books in a manner that would produce extraction of the same or equivalent data from those carriers. This lack of comparability demonstrates the fundamental disconnect between regulatory accounting rules applied only to ILECs and the "necessary" test of Section 11.

Qwest agrees with AT&T's premise that uniform accounting practices among carriers are important to the FCC and to the industry. Qwest disagrees with AT&T on two points: 1) the need for uniformity cannot be translated into a need for a separate regulatory accounting regime, especially in light of the requirement that publicly-held carriers comply with GAAP and SEC accounting and reporting requirements; 2) the need for uniformity of accounting practices cannot be fulfilled by a regulatory accounting structure that includes only one segment of the industry, excluding AT&T and all other non-ILEC market participants.

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[32] *See* Qwest Comments at 2.

[33] AT&T's position that it be excluded from accounting rules adopted to evaluate and measure the competitive market simply makes no sense.

C. The FCC's Authority To Enact Accounting Rules Solely To Assist State Regulators Is Limited.

A number of commentors argue that the FCC should retain and continue to enforce accounting regulations that no longer meet the "necessary" test if a state regulator has need or use for the same information.[34] This argument is inconsistent with the statutory structure. Section 11 of the 1996 Act is focused primarily on the national "public interest" as overseen by this Commission. State regulatory use of accounting rules imposed by the FCC is not sufficient to meet the "necessary" test of Section 11. States that desire accounting information that differs from that reported to the SEC or retained pursuant to GAAP or any special accounting rules that the FCC adopts for its own needs (consistent with Section 11) have the power to obtain this information from the carriers they regulate. What is more, even if the FCC were to accept the premise that the "necessary" test could be based on a state, rather than a federal need, a state desiring that the FCC adopt a regulation requiring an accounting practice (or reporting requirement) would need to demonstrate, on an individual basis, that the state's need for the information met the strictures of the federal "necessary" test.[35] The likelihood that such a showing could be made is slim, and no commentor has thus far even attempted to demonstrate how the "necessary" test could apply in a state regulatory context.

Qwest does not deny the importance of the availability of uniform information to all regulators (and to others in the industry). Information derived from GAAP and SEC accounting and reporting is, and will be, available to state regulators, as will those federal reports that meet the "necessary" standard. The question here is whether, under the "necessary" test, it would be

[34] AT&T at 8-9; FPSC at 4; NASUCA at 5; Wisconsin at 17; WorldCom at 2.

[35] This would lead to the anomalous practice of the FCC evaluating the bona fides of a state's "need" for a particular federal accounting rule. Qwest submits that this is an exercise that the FCC would not want to undertake even if it were permitted under the 1996 Act, which it is not.

lawful for the FCC to require certain accounting practices that differ from GAAP and are not needed by the FCC in carrying out its own regulatory mandates, solely on the basis that additional information is desired by state regulators. This is not a proper construction of the "necessary" language in Section 11.

Furthermore, commentors arguing that FCC regulatory accounting rules should be continued or expanded to meet state needs assume a level of comparability among the states that does not exist. Beyond the uniformity provided by GAAP, the SEC and other FCC rules, comparisons of telecommunications carriers among states are generally not relevant and are often misleading. Each state has a unique regulatory environment, in addition to unique geography, network deployment, climate and market. States have pointed to this uniqueness for years in supporting their jurisdiction over intrastate telecommunications.[36] A state need, absent a federal need, does not meet the test of Section 11.

## IV. THE FOCUS OF ARMIS OR ANY OTHER REPORT REQUIRED BY THE FCC SHOULD BE ON INFORMATION CONCERNING COMPETITION IN THE TELECOMMUNICATIONS INDUSTRY.

A number of commentors continue to assert that the ARMIS Reports should be continued to be required to be filed by ILECs, particularly the especially onerous reports required of RBOCs.[37] Ironically, these commentors also argue that the ARMIS data is a vital component in understanding and evaluating the progress of telecommunications competition.[38] This argument is key to understanding the position of these commentors, because the ARMIS Reports are applicable only to a small segment of the industry, generally reflect historical accounting costs,

[36] *See*, *e.g.*, *In the Matter of Federal-State Joint Board on Universal Service, Report and Order*, 12 FCC Rcd. 8776, 8842 ¶ 118 (1997).

[37] *See*, *e.g.*, AT&T at 7, 13, 17; FPSC at 4; North Carolina at 2-3.

[38] *See*, *e.g.*, FPSC at 4; North Carolina at 4.

and cannot possibly form the basis for meaningful analysis of competitive developments. What is more, there are currently in place reporting requirements of much more general applicability that provide better information than do the ARMIS Reports. For example, the current Universal Service Fund Monitoring Report presents an industry-wide view of revenues for universal service fund purposes.[39] This data is much more meaningful and paints a more accurate picture of market developments than the RBOC-only ARMIS Reports. Continued filing of the ARMIS Reports cannot be justified under Section 11.

Qwest agrees that the FCC has an express mandate to evaluate continuously the state of competition in the telecommunications market. Indeed, one such evaluation is the instant biennial review. However, as is the case with accounting rules, the mere fact that the FCC needs to evaluate competitive conditions in the telecommunications industry does not mean that any data remotely connected to competition may be subject to mandatory filing rules, especially when reported only by ILECs. The data subject to the FCC's reporting requirements must, in order to meet the "necessary" test, be meaningful, directly related to the purpose for which it is being collected, and not realistically available through some less burdensome means.

In the case of ARMIS, continuation of the mandatory filing of the ARMIS Reports cannot meet the "necessary" test because ARMIS data is collected from only one industry segment. This means that the ARMIS information is not relevant to the regulatory purpose that it is intended to meet. Comparisons among carriers to determine actual competitive developments based on ARMIS data cannot be made because the scope of the data is simply too limited. Data must be collected from all participants in order to be meaningful in making

[39] *See* Qwest Comments at 5-7 and n.6.

competitive analyses. The ARMIS Reports, no matter how configured, cannot reasonably be applied to the entire industry. For that reason alone, they should be discontinued.

Moreover, the accounting ARMIS Reports are based on historical accounting costs. Historical costs are not relevant in evaluating competitive markets.[40] These costs tell what a carrier spent in the past to provide service, and the extent to which its existing plant has been depreciated. Such information is relevant in determining whether a carrier's rates are reasonable when calculated on a rate-of-return basis. But such costs tell the FCC nothing about the state of competition in the present time, which is what any reasonable competitive analysis must assess. The ARMIS historical cost reporting structure, even if applied to the entire industry, would still not produce cost information that could be used in conducting the meaningful competitive evaluations that are a vital part of the FCC's regulatory responsibility under the 1996 Act.

In other words, those arguing for a continuation of ARMIS reporting miss the essential connector required by Section 11(b) of the 1996 Act: Is the regulation in question reasonably related to a valid regulatory purpose? The mere fact that the regulatory purpose is valid and salutary does not mean that the rule is reasonably related to that regulatory goal. In the case of ARMIS Reports, because they seek the wrong information from an artificially-restricted segment of the industry, continued filing of these Reports cannot be justified under Section 11.

## V. CONCLUSION

Based on the foregoing, Qwest submits that a radical reexamination of the FCC's existing accounting and reporting requirements is necessary. The existing rules are not suited to the regulatory purpose that they are intended to fulfill, and needlessly duplicate accounting and reporting rules and practices overseen by other agencies and independent bodies. As such, they

[40] The FCC has consistently held that historical or embedded costs are irrelevant in a competitive marketplace. *See*, *e.g.*, *Local Competition Order*, 11 FCC Rcd. at 15857-79 ¶¶ 704-707.

are no longer "necessary in the public interest." Except in those rare instances where the FCC finds upon a record that additional accounting or reporting requirements beyond those already imposed elsewhere are an essential component to its ability to evaluate and monitor the development of competition, the FCC must either repeal or modify any such rules in order to meet the "necessary" test imposed by Section 11(b) of the 1996 Act.

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February 19, 2003

CERTIFICATE OF SERVICE

I, Richard Grozier, do hereby certify that I have caused the foregoing **REPLY COMMENTS OF QWEST CORPORATION** to be (1) filed with the FCC via its Electronic Comment Filing System, (2) a copy of the **REPLY COMMENTS** to be served, via e-mail on the parties marked with an asterisk (*), and (3) a copy of the **REPLY COMMENTS** to be served, via First Class United Stated mail, postage pre-paid, on all other parties listed on the attached service list.

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February 19, 2003

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